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IN THE

Supreme Court of the United States

October Term, 1966.

No. 428.

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

UNITED BENEFIT LIFE INSURANCE COMPANY.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

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No. 428

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

v.

UNITED BENEFIT LIFE INSURANCE COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law and order of the United States District Court for the District of Columbia are unreported, and appear in Volume I of the two volume Joint Appendix (JA I, 105-107) filed in the United States Court of Appeals for the District of Columbia Circuit. The opinion of the Court of Appeals is reported at 359 F. 2d 619, and a copy thereof is appended to the Petition as Appendix A (App. A of Pet. 16-23).

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether a deferred annuity contract issued by a major life insurance company, in which contract the obligations of the company are stated in large part in terms of guaranteed dollar amounts, and which contract, as found by the court below, imposes upon the company for its entire duration, (a) all of the mortality risk, (b) all of the expense risk, and (c) not only a substantial part, but by far the major part of the investment risk associated with the annuity—is an "insurance" product exempt as such from federal regulation, and not a security subject to federal regulation, within the test established in this Court's decision in *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company of America,* 359 U.S. 65 (1959), under which to qualify its products as "insurance" an insurance company must bear not only the mortality and expense risks associated with the contract but a substantial part of the investment risk.

STATUTES INVOLVED

The pertinent provisions of the Securities Act of 1933 (48 Stat. 74, 15 U.S.C. 77a, *et seq.*) and of the Investment Company Act of 1940 (54 Stat. 789, 15 U.S.C. 80a-1, *et seq.*) are set forth in Appendix B of the Petition. The provisions of Section 2(b) of the McCarran-Ferguson Insurance Regulation Act (59 Stat. 34, 15 U.S.C. 1012(b)) are set forth in Appendix A, *infra,* 23.

COUNTERSTATEMENT OF THE CASE

The Securities and Exchange Commission (SEC) petitions for review of the judgment of the United States Court of Appeals for the District of Columbia Circuit entered March 10, 1966 (App. B of Pet. 24), which affirmed the judgment of the United States District Court for the District of Columbia, entered April 5, 1965 (JA I, 107), dismissing on its merits the SEC complaint for an injunction (JA I, 5-21) filed on October 1, 1962, against respondent United Benefit Life Insurance Company (United) seeking to enjoin United from issuing its Flexible Fund Annuity (FFA).

United was incorporated in 1926 under the insurance laws of the State of Nebraska (JA I, 105), as a legal reserve, stock, life insurance company.[1] United is a life insurance company subject to the supervision of the Director of Insurance of the State of Nebraska and of the insurance commissioner (or similar official) of the District of Columbia and of the States [2] in which it is authorized to do business (JA I, 105).

This Court's controlling decision in Securities and Exchange Commission v. Variable Annuity Life Insurance Company of America

As the court below pointed out in its opinion (App. A of Pet. 18), "The result in this case, as both parties recognize, is controlled by the Supreme Court's recent

1. As of December 31, 1963, United had assets exceeding $458 million (Pl. Ex. 7; JA II, 38); capital and surplus exceeding $60 million (*id.*, 39); and contracts in force with face amount benefits in excess of $3.2 billion (*id.*, 48).

2. United is authorized to transact business in all States of the United States except New York (Pl. Ex. 7; JA II, 54).

decision" in *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company of America*, 359 U.S. 65 (1959) (*VALIC*). In the *VALIC* case the question before this Court was whether the issuers of variable annuities were issuing a "security" within the meaning of the Securities Act of 1933 and Investment Company Act of 1940, or whether they were issuing "contracts of insurance" (*id.* at 68), which would be exempt from these Acts by their own terms, as well as by the provisions of the McCarran-Ferguson Act. A majority of this Court [3] found that the variable annuity companies had assumed the mortality and expense risks usually associated with insurance; however, since these companies did not guarantee that ". . . at least some fraction of the benefits will be payable in fixed amounts . . ." the variable annuity placed ". . . all of the investment risk on the annuitant, none on the company . . .". Because the federal [4] concept of insurance requires ". . . some investment risk-taking on the part of the company . . .",

3. Mr. Justice Douglas—speaking also for the Chief Justice, and Justices Black, Brennan and Stewart—wrote the opinion of the Court. Mr. Justice Brennan concurred in a separate opinion (359 U. S. at 73-93), in which Mr. Justice Stewart joined. Mr. Justice Harlan—whom Justices Frankfurter, Clark and Whittaker joined—dissented in a separate opinion (359 U. S. at 93-101). The dissenters held that the variable annuity is an "insurance contract", subject only to state regulation.

4. This Court noted in *VALIC* that how the States may have ruled on the variable annuity was "not decisive" since the meaning of "insurance" or "annuity" under the federal securities laws is a "federal" question (359 U. S. at 69). As of October 1962, the FFA contract issued by United had been approved by the insurance commissioners of 17 States (JA I, 35), and United had issued 132 FFA policies (JA I, 97).

this Court concluded that the variably annuity was not "insurance", and hence was subject to federal regulation. This Court said (359 U.S. at 70-72, footnotes omitted):

> The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of what the portfolio of equity interests reflects —which may be a lot, a little, or nothing. We realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of "insurance" or "annuity" into the mold they fitted when these Federal Acts were passed. But we conclude that the concept of "insurance" involves some investment risk-taking on the part of the company. The risk of mortality, assumed here, gives these variable annuities an aspect of insurance. Yet it is apparent, not real; superficial, not substantial. In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense. . . . We deal with a more conventional concept of risk-bearing when we speak of "insurance." For in common understanding "insurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts. . . . The companies that issue these annuities take the risk of failure. But they guarantee nothing to the annuitant except an interest in a portfolio of common stocks or other equities—an interest that has a ceiling but no floor. There is

no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage.

The decision of the District Court

The District Court granted United's motion to dismiss the action made at the conclusion of the SEC's case (JA I, 103); holding that United's deferred annuity contract in question, the FFA [5] is "an insurance product within the interpretation of *VALIC*" (JA I, 107). The District Court held that within the meaning of this Court's decision in the *VALIC* case, United had assumed the investment risk involved in providing "a guaranteed basic fixed dollar monthly equal retirement income, after the maturity date has been reached, which cannot be outlived" (finding of fact no. 5 and conclusion of law no. 3; JA I, 105-106).

The decision of the Court of Appeals

The Court of Appeals affirmed the judgment of the District Court; it concluded under this Court's *VALIC* decision "that the FFA is an 'insurance' contract and as such beyond the scope of federal regulation under the 1933 and 1940 Acts" (App. A of Pet. 23).

The court below found in its opinion (App. A of Pet. 20) that in most respects the traditional deferred annuity and the FFA are identical; that the only "meaningful difference" between the two is that the FFA does not guarantee interest on the accumulation of net premiums during the deferred period, but in-

5. The contract in question is denominated the "Annual Premium Flexible Fund Retirement Annuity" (Pl. Ex. 2; JA II, 2). We refer to the contract, as did the court below, as the "FFA" (Flexible Fund Annuity).

stead promises 100 per cent of net premiums *plus* the difference between 100 per cent of net premiums and the accumulated cash value of the FFA, if higher. In this latter respect the court below said that the FFA "can be regarded as an extension or development of the concept of participating insurance", since the FFA, like a participating policy, gives the opportunity to share in greater interest when that is earned (App. A of Pet. 22-23, n. 11).

The essential provisions of the FFA were summarized in the opinion of the court below, as follows (App. A of Pet. 20, footnote omitted):

> In most respects the FFA and the traditional deferred annuity are identical. Both guarantee interest on principal during the pay-out period; both assume all mortality and expense risks throughout the term of the contract; and both provide death benefits and cash surrender values. The only meaningful difference between the FFA and the conventional deferred annuity is that the FFA does not guarantee interest on the accumulation of net premiums during the deferred period, but instead promises 100 per cent of net premiums plus a share in any profits made by the investment and reinvestment of the money in the Flexible Fund.

The reference to the "Flexible Fund" in the foregoing quotation is to "Flexible Fund A Account" (Pl. Ex. 2; JA II, 3), a separate account maintained by United under Nebraska law[6] in connection with the FFA

6. Section 44-310.06 of Revised Statutes of Nebraska, 1963 Cumulative Supplement, provides, in part, that a life insurance company may allocate to one or more separate accounts, pursuant to the

policies which have been issued. A separate account is an "operational manner of proceeding whereby a life insurance company is able to perform its legally incurred obligations to a special segment of its policyholders".[7]

The guaranteed dollar amount provisions of the FFA

The FFA is a deferred annuity contract; it is a "fixed annuity" within the meaning of this Court's *VALIC* opinion where the Court said that a fixed annuity is one which offers "the annuitant specified and definite amounts beginning with a certain year of his or her life" (359 U.S. at 69). The FFA—as a fixed annuity—thus enables the annuitant—as the variable annuity does not—to "look forward to a fixed monthly or yearly amount in his advancing years" (359 U.S. at 70).

The specified and definite amounts which United will pay to the annuitant commencing on the maturity

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provisions of applicable contracts, any amounts which are paid to such company in connection with an annuity; and provides also that "amounts allocated by a life insurance company to separate accounts in the exercise of the power granted . . . shall be owned by the company, and the company shall not be, or hold itself to be, a trustee in respect to such amounts."

7. *A Symposium on Segregated Accounts,* PROCEEDINGS OF THE FIFTY-FOURTH ANNUAL MEETING OF THE LEGAL SECTION OF THE AMERICAN LIFE CONVENTION, p. 264. The National Association of Insurance Commissioners requires all life insurance companies to report all transactions involving separate accounts. Therefore, United's Annual Statement for 1962 includes Form 1-S (Pl. Ex. 8(b); JA II, 67-92) which relates to the separate account used in connection with FFA policies to compute their accumulated cash values. Form 1-S relates to transactions involving the separate account only, and the many other aspects of United's operations which relate to FFA policies are reflected throughout Form 1 of United's Annual Statement (Pl. Ex. 8(a); JA II, 35-66).

date selected by the annuitant depend, in part—as in the case of any deferred annuity—upon the cash value of the annuity at maturity plus an assumed interest factor during the pay-out period. Table 1 of the FFA (Pl. Ex. 2; JA II, 5), is a table of monthly payments to be received for the lifetime of the annuitant under specified options for each $1000. of cash value available on the maturity date; the table is identical with that embodied in United's traditional deferred annuity as issued in 1962 when suit was begun (see p. 11, n. 10 *infra*); both tables are predicated upon identical mortality and interest (2½ per cent) assumptions during the pay-out period.

In the hypothetical case of an FFA issued to a male annuitant at age 35, with a monthly premium of $100.; the annuitant having elected Option A, providing for a lifetime retirement income with 120 months guaranteed (Pl. Ex. 2; JA II, 5)—the annuitant is guaranteed that he will receive after maturity each month the specified and definite amounts which will be provided by amounts of the guaranteed minimum cash value, which amounts are calculable from the policy.

The guaranteed minimum cash value of the FFA consists—after the 10th policy year—of 100 per cent of net premiums, and prior thereto of an increasing percentage [8] of the net premiums [9] which have been

8. The FFA provides that the guaranteed minimum cash value shall be determined by applying the appropriate percentage to the sum of the net premiums which have been paid; these percentages range from 50 per cent of the premiums paid for the 1st year, to 90 per cent after premiums have been paid for 9 years, and to 100 per cent after premiums have been paid for 10 or more years (Pl. Ex. 2; para. 9; JA II, 3). Since the FFA is an instrument of long-range retirement planning, United will not issue an FFA unless the maturity date is at least 10 years from the date of issue (Pl. Ex. 3; JA II, 19).

9. (Footnote appears on succeeding page.)

paid by the annuitant. In the foregoing hypothetical case, with an assumed maturity date at the end of the 25th policy year; *i.e.*, at male age 60, the annuitant would receive for life after the maturity date monthly payments of $154.13. The amount of the monthly payment is calculated by determining the monthly payment under Table 1 in the FFA (Pl. Ex. 2; JA II, 5) for each $1000. of guaranteed minimum cash value (Pl. Ex. 2, para. 9; JA II, 3) for a male age 60. In the foregoing hypothetical case the guaranteed minimum cash value at the end of the 25th policy year would be $27,474.; and the amount payable per each $1000. of such cash value under the table would be $5.61 ($27.474 \times 5.61 = 154.13$).

The guaranteed minimum cash values at the end of certain policy years of the FFA under the assumptions of the foregoing hypothetical case, and the lifetime monthly income payments provided thereby, are stated in a table below; there is also given, by way of comparison, the cash values at the end of the same policy years and the lifetime monthly income payments

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9. Net premiums are defined in the FFA as the following percentages of the premiums paid for respective policy years (Pl. Ex. 2, para. 7; JA II, 3):

Policy Year	*Percentage of Premiums Paid*
1	50.0
2-10	90.5
11 and subsequent	95.0

The expense "loadings" built into the premium for the FFA, therefore, amount to: 50.0 per cent in the 1st year; 9.5 per cent in years 2-10; and 5.0 per cent in the 11th year and thereafter.

provided thereby in United's traditional deferred annuity,[10] under the same assumptions:

End of Policy Year	United's FFA Deferred Annuity: Minimum Guaranteed Cash Value	United's FFA Deferred Annuity: Monthly Payment For Life	United's Traditional Deferred Annuity: Guaranteed Cash Value	United's Traditional Deferred Annuity: Monthly Payment For Life
10	$10,374.00	$ 42.43	$11,561.08	$ 47.28
15	16,074.00	72.33	18,749.25	84.37
20	21,774.00	109.09	26,895.08	134.74
25	27,474.00	154.13	36,102.40	202.53

In addition to the provisions for the guaranteed minimum cash value and for the guaranteed lifetime income provided thereby, the FFA obligates United upon the death of the annuitant during the deferred period to pay to the annuitant's beneficiary as a guaranteed minimum death benefit—100 per cent of the sum of the premiums which have been paid by the annuitant (Pl. Ex. 2; JA II, 2).

The accumulated cash value benefits of the FFA

The cash value of the FFA during the deferred period can never be less than the guaranted minimum cash value. The FFA, however, makes provision for an accumulated cash value—(Pl. Ex. 2, para. 8; JA II, 3) which may provide benefits in addition to the guaranteed minimum cash value. The accumulated cash value is based upon the monthly accumulation

10. The values given in the chart for United's traditional deferred annuity are predicated upon the form of that contract (Form 523, Series 74L) as issued at the time the SEC complaint was filed herein in October, 1962. The record contains a newer series of the same contract (Form 523, Series 140L) (Pl. Ex. 7; JA II, 27-34), which liberalized its interest assumptions, and modernized its mortality assumptions.

rate[11] (Pl. Ex. 2, para. 12; JA II, 3), which rate in turn depends upon the value of United's assets acquired with funds allocated by it to the separate account.

The pay-out provisions of the FFA—like those of United's traditional deferred annuity—are predicated, in part, upon an accumulation rate consisting of a fixed interest factor (2½ per cent). During the deferred period, however, the FFA provides for an accumulation rate which does not consist of a fixed and limited interest factor, but of an empiric accumulation rate—the monthly accumulation rate—under which net premiums are accumulated at a rate which reflects actual investment results. This empiric accumulation rate, the court below held, "can be regarded as an extension or development[12] of the concept of participating insurance" (App. A of Pet. 23, n. 11).

As noted above, the cash value of the FFA can never be less than the guaranteed minimum cash value. The FFA thus protects the annuitant's "principal" *i.e.* 100 per cent of the net premiums, and thus guarantees to the annuitant the lifetime monthly payments which will be provided for by the guaranteed minimum cash value. If, however, on the maturity date selected by the annuitant the accumulated cash value is higher than the guaranteed minimum cash value—as a result of favorable investment results achieved by United dur-

11. A summary of the arithmetical steps involved in calculating the monthly accumulation rate appears in the record (JA I, 80-81).

12. The FFA differs from the usual participating annuity in that, in most favorable fashion to the annuitant, United agrees that the annuitant will receive the full benefit of favorable investment results over the deferred period, limiting its charges to a reserve for possible income taxes of United and to the actuarial margin of .083 per cent per month.

ing the deferred period—then the annuitant will receive not merely the lifetime monthly payments provided for by the guaranteed minimum cash value, but *additional* amounts of lifetime monthly payments above the guaranteed minimum level—which additional amounts will be provided for by the additional amount of accumulated cash value over the guaranteed minimum cash value. In the foregoing hypothetical case, the annuitant would receive in addition to his lifetime monthly payment of $154.13—a payment of an additional $5.61 per month for each $1000. of accumulated cash value above the guaranteed minimum cash value, as per Table 1 of the FFA (Pl. Ex. 2; JA II, 5).[13]

The FFA provides—as does United's traditional deferred annuity—that the annuitant has the *option* upon the maturity date (or earlier) to surrender the contract, thus terminating his contractual relationship, and to receive the cash value of the FFA. If the annuitant exercises this option[14] to terminate his FFA contract, he will receive the guaranteed minimum cash value *plus* the difference between the guaranteed minimum cash value and the accumulated cash value—if

13. The lifetime monthly payments per each $1000. of cash value provided for by Table 1 in the FFA—as well as the mortality, expense and interest assumptions upon which the payments are based—are fixed from the moment the FFA policy is issued. No matter how long the duration of the FFA contract they may not be changed by United adversely to the annuitant.

14. It is significant that Section 3(a)(8) of the Securities Act of 1933 (App. C of Pet. 25) provides, in pertinent part, that the Act shall *not* apply to "any insurance or endowment policy or annuity contract or *optional annuity contract* * * *" (emphasis added). The FFA is an "optional annuity contract" within the meaning of the foregoing exemption provision of the Act, as are most deferred annuities being issued by United States life insurance companies today.

the latter is higher—in the form of a terminal dividend representing such difference.

Also, if the annuitant dies before the maturity date, his beneficiary will receive the amount of the guaranteed minimum death benefit (the sum of the premiums which have been paid) *plus* the difference between that minimum amount and the accumulated cash value—if the latter is higher—in the form of a terminal dividend representing such difference.

REASONS FOR DENYING THE WRIT

The court below noted in its opinion that "The result in this case, as both parties recognize, is controlled by the Supreme Court's recent decision in the *VALIC* case" (App. A of Pet. 18). This Court in *VALIC*, decided an important[15] question of Federal law and after the fullest presentation of all possible contentions.[16] The SEC has not advanced any reason in the Petition why this Court should once again cover the ground so recently and elaborately covered in its *VALIC* decision. The SEC Petition is obscure,[17] but it must be presumed that the sole proffered ground of review is that the decision of the court below allegedly *conflicts* with this Court's decision in the *VALIC* case; that the court below allegedly misconstrued or misap-

15. Certiorari was granted in *VALIC* "because of the importance of the question presented" (359 U. S. at 66).

16. Briefs were filed by the two respondent variable annuity companies and by the two petitioners, SEC and National Association of Securities Dealers, Inc.

17. The SEC at one point in the Petition asserts that the court below held "that *VALIC* is inapplicable . . . (Pet. 7); at another point the SEC asserts "We submit that, contrary to the view of the court of appeals, this Court's decision in *VALIC* does not sanction such a result" (Pet. 15).

plied this Court's *VALIC* decision. However, such alleged conflict is non-existent. The decision of the court below is manifestly correct.

In the light of this Court's *VALIC* decision and the SEC's concessions at the trial[18] no other result could really have been reached. Since this Court's *VALIC* decision already sets forth a clear test for determining whether or not an insurance company is issuing an "insurance contract" exempt from regulation under the federal securities laws, there is no need for review by this Court. The court below in a careful opinion correctly understood this test and correctly applied it to the particular provisions of the FFA contract before it.

I. The court below correctly interpreted this Court's VALIC decision

After a review of this Court's opinions in *VALIC*, the court below held that: "In sum, both the majority and concurring opinions implicitly held that a company must bear *a substantial part* of the investment risk associated with the contract, as well as the mortality and expense risks in order to qualify its products as "insurance" (emphasis added) (App. A of Pet. 19-20).

Further, answering the SEC contention made in the court below—which is repeated in the Petition—that "so long as the contract allows the annuitant *any* direct participation in the investment experience of the company, the policy *must* be subject to the fed-

18. In the District Court the SEC conceded herein that there is no "floor" to the variable annuity (JA I, 51) while there is a "floor" in the FFA. The SEC also conceded that the holder of an FFA "can't wind up with nothing", since the guaranteed minimum cash value will always provide a lifetime income (JA I, 52).

eral regulatory scheme" (emphasis added), the court below said (App. A of Pet. 22, n. 10):

> . . . This argument ignores completely the language and logic of *VALIC*, which contemplated *a test based on the substantiality of the investment risk assumed by the company.* See 359 U.S. at 71-73, 85, 89. . . . (Emphasis added).

The court below was indisputably correct in interpeting this Court's *VALIC* decision as setting forth a test based upon the "substantiality of the investment risk assumed by the company".

II. The court below correctly applied the test set forth in this Court's VALIC decision to the FFA

The court below applied this Court's *VALIC* test —*i.e.* that an insurance company must bear "a substantial part" of the investment risk associated with the annuity policy—to the contract in question, and held correctly that United has assumed in the FFA "not only a *substantial part,* but by far the *major part,* of the investment risk over the duration of the entire policy." (Emphasis added) (App. A. of Pet. 22).

A. The court below found (App. A of Pet. 20) that in most respects the FFA and the traditional deferred annuity are identical. Both are premised upon a fixed interest accumulation factor during the entire pay-out period. Both assume all mortality and expense risks [19] throughout the duration of the entire contracts. Both provide death benefits and cash sur-

19. The premium expense "loadings" of the FFA are identical with those of United's traditional deferred annuity. In the case of the FFA a so-called "actuarial margin" equal to .083 per cent of the value of the investments allocated to the separate account is transferred each month during the deferred period from the separate

render values during the deferred periods of the contracts.

The court below held that the "only meaningful difference" between the FFA and the traditional deferred annuity is that the FFA—during the deferred period only [20]—is not based upon a fixed interest assumption on the accumulation of net premiums during the deferred period, but instead promises 100 per cent of net premiums—the guaranteed minimum cash value —*plus* the difference between such guaranteed minimum cash value and the accumulated cash value—if the latter is higher.

B. The contentions made by the SEC in the court below—all of which are repeated in the Petition—are summarized in the opinion of the court below, as follows (App. A of Pet. 20-21):

> The SEC would minimize the similarities between the FFA and the deferred annuity first by

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account to United's general funds. United guarantees that the only expense charges in connection with the FFA over the entire duration of the contract will be (a) the amount of expense premium "loadings", (b) the monthly "actuarial margin" charge of .083 per cent, and (c) a reserve for United's income taxes, if any. If United's actual expenses over the entire duration of the FFA contract exceed these allowances United will bear the loss.

20. The SEC concedes (Pet. p. 12) that in the pay-out period the FFA is clearly an "insurance product." As to the SEC contention that the FFA contract should *not* be construed as a whole and in its entirety, the court below said (App. A of Pet. 22):

> . . . we reject the SEC's basic premise that the contract should be fragmented and the risk during the deferred period only should be considered. United's guarantee of principal and 2½ per cent interest during the pay-out period is a very substantial assumption of investment risk, which should not be ignored. Indeed, the *VALIC* opinions, as well as common sense, indicate that a challenged policy should be viewed as a whole in order to test its amenability to federal regulation. . . .

asserting jurisdiction only over the deferred portion of the contract. The SEC then contends that the "investment risk" referred to in *VALIC* is the risk of not earning interest on the principal sum invested and that a contract is not "insurance" unless interest as well as principal is guaranteed. In support of this position the SEC emphasizes the extent to which the fortunes of the annuitant depend upon the investment policies and experience of the Fund and argues that the court should not treat the minimum guarantee of 100 per cent of net premiums as a substantial assumption of investment risk because it is extremely unlikely that the Fund's investment experience will be so disastrous as to call the guarantee into effect.

Each of the foregoing contentions is without merit; each was properly rejected by the court below, as follows:

(1) The court below pointed out that the adoption of the SEC's position—that interest *must* be guaranteed during the deferred, as well as during the payout period—would freeze and restrict annuity policies essentially to their current form. This result would contravene—said the court below—the explicit warning of this Court in *VALIC* where all[21] the members of this Court counseled against "freezing" the concept of annuity into a single pattern, and held that development and growth of insurance concepts should be allowed (App. A of Pet. 21).

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21. In *VALIC* Mr. Justice Douglas said in the Court's opinion:

> We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. . . . (359 U. S. at 68).

(2) The court below held that by guaranteeing the annuitant's "principal"—100 per cent of net premiums paid—United had assumed in the FFA a "substantial part" of the investment risk during the deferred period [22] of the contract (App. A of Pet. 21). The court below held also that by guaranteeing principal and interest (at 2½ per cent) during the pay-out period of the contract, United had also undertaken "a very substantial assumption of investment risk" (*id.*

. . . And we would not undertake to freeze the concepts of "insurance" or "annuity" into the mold they fitted when these Federal Acts were passed. . . . (*Id.* at 71).

Mr. Justice Brennan said in his concurring opinion:

. . . the point is not that if the insurance industry seeks to retain its exemption, it must limit itself to the forms of policies and contracts in effect in 1933 and 1940. . . . (*Id.* at 76).

Mr. Justice Harlan said in his dissenting opinion:

. . . The Court is agreed that we should not "freeze" the concept of insurance as it then existed. By the same token we should not proceed on the assumption that the thrust of state regulation is frozen. As the insurance business develops new concepts the States adjust and develop their controls. This is in the tradition of state regulation and federal abstention. . . . (*Id.* at 101).

22. Conceding that United bears the full investment risk associated with the pay-out portion of the FFA, the SEC contends that United's guarantee of 100 per cent of net premiums during the deferred period accords "only the barest form of protection" (Pet. 11). As the court below cogently pointed out, this is a guarantee of the annuitant's "principal", and "[w]ere the annuitant to invest on his own in the stock market, or even in so-called 'safe' securities like bonds and mortgages, he would not have this guarantee, and his principal would never be absolutely secure" (App. A of Pet. 21-22). If on the maturity date the value of United's investments associated with the FFA contract should fall to *0*, the FFA holder would, nevertheless, receive for life the monthly payments provided for by the guaranteed minimum cash value.

p. 22). The court below, therefore, properly concluded that:

> . . . All told, United has assumed not only a substantial part, *but by far the major part* of the investment risk over *the duration of the entire policy*. . . . (Emphasis added) (App. A. of Pet. 22)

Further, making direct application of language of this Court's majority opinion in *VALIC* to the instant contract, the court below held (App. A of Pet. 22-23):

> . . . The obligations of United under the FFA, unlike those of the variable annuity, are stated, in large part, in terms of *guaranteed dollar amounts;* there is a *substantial* and *meaningful "floor"* to the FFA policy. . . . (Emphasis added.)

(3) As the court below pointed out (App. A of Pet. 22, n. 10) the SEC concedes that a *participating* annuity is exempt from federal regulation; the participating annuity, however, provides, and is intended to provide, that "the annuitant will participate directly, even if minimally, in the investment experience of the company." The court below further pointed out that "the substantiality of the investment risk which United assumes in the FFA is even more apparent when the policy is compared with a participating annuity[23] (App. A of Pet. 22, n. 11):

> . . . In the latter [the participating annuity], the interest factor during the deferred period is

23. The passing on by life insurance companies of the benefits of favorable investment experience has been traditional in the United States. In fact, of the total amount of all types of life insurance in force with United States life companies at the end of 1965, participating insurance accounted for 64 per cent. LIFE INSURANCE FACT BOOK, 1966 (Institute of Life Insurance), p. 22.

deliberately set quite low so as to assure dividends; and while dividends are in theory discretionary, in practical terms they must be declared regularly or the company will lose too much business. In effect, a participating policy promises, in part, a smaller interest guarantee in return for the opportunity to share in greater interest when that is earned. See *e.g.* HUEBNER & BLACK 387-402; MEHR & OSLER 598-605, 614-20. For this reason the FFA can be regarded as an extension or development of the concept of participating insurance.

C. The FFA—as is any deferred annuity—is an instrumentality of long range retirement planning, and the annuitant acquires the FFA to obtain the guaranteed lifetime income provided thereby. The fact that it contains, during the deferred period, an accumulation rate which may provide the annuitant with bonus benefits—if long range trends in the economy are favorable—while protecting the annuitant's "principal" does not convert such a deferred annuity contract into a security. The court below was clearly correct in so holding.

CONCLUSION

For the foregoing reasons, this cause should not be reviewed by the Court, and the Petition for a writ of certiorari should be denied.

Respectfully submitted,

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